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CINCEUR

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C O N F I D E N T I A L SECTION 1 OF 5 USNATO 0343

E.O. 11652: GDS

TAGS: PFOR, MILI, NATO, OR, XF, XG, XI

SUBJECT: NATO STUDY ON THE IMPLICATIONS OF REOPENING THE SUEZ CANAL

REF: USNATO 0325

HEREWITH TEXT OF UK PAPER DATED JANUARY 20.

THE PRINCIPAL IMPLICATIONS OF THE REOPENING
OF THE SUEZ CANAL

INTRODUCTION AND SUMMARY

1. THERE ARE PROSPECTS THAT THE SUEZ CANAL, HAVING BEEN CLOSED
TO ALL SHIPPING SINCE 1967, WILL REOPEN FOR COMMERCIAL SHIP-
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PING WITHIN THE NEXT YEAR. IN THIS PAPER WE ATTEMPT TO ASSESS
THE ECONOMIC IMPLICATIONS OF THE REOPENING OF THE CANAL FOR
COUNTRIES IN THE AREA AND SOME WIDER ECONOMIC IMPLICATIONS
FOR OIL, NON-OIL TRADE AND SHIPPING. WE LOOK AT FUTURE PLANS

TO DEVELOP THE CANAL AND LIKELY TIMINGS, AND TRY TO ESTIMATE HOW HEAVY THE TRAFFIC WILL BE. WE ALSO EXAMINE THE PROBABLE POLITICAL AND ECONOMIC EFFECTS ON COUNTRIES IN THE AREA, THE STRATEGIC EFFECTS AND THE IMPLICATIONS FOR THE BALANCE OF EAST/WEST ADVANTAGE.

2. WE HAVE HAD TO WORK ON THE ASSUMPTION THAT THE CANAL, ONCE OPENED, WILL NOT BE CLOSED AGAIN BY THE OUTBREAK OF HOSTILITIES IN THE AREA AND THAT THERE WILL BE A PERIOD OF RELATIVE STABILITY. WE RECOGNISE, HOWEVER, THAT THIS IS A BOLD ASSUMPTION.

3. THERE IS REPAIR WORK STILL TO BE DONE ON THE CANAL AND IT IS UNLIKELY TO BE BACK TO ITS 1967 CONDITION MUCH BEFORE THE END OF 1975. THE EGYPTIANS HAVE SAID THEY WILL NOT OPEN THE CANAL TILL THE ISRAELIS STAGE A MAJOR WITHDRAWAL IN SINAI. THE EGYPTIANS HAV A TWO-STAGE PLAN WHICH WILL TAKE SIX YEARS TO ENLARGE THE CANAL.

4. MANY OF THE WORLDS PRESENT OIL TANKERS WILL BE TOO LARGE TO USE THE CANAL ON REOPENING AND THIS MIGHT REMAIN A LIMITING FACTOR AT LEAST UNTIL THE SECOND STAGE OF ENLARGEMENT. HOWEVER, THE EXPECTED EXPANSION IN BOTH CRUDE OIL AND OIL PRODUCT TRADE FROM THE GULF SHOULD ENSURE THAT THE CANAL IN TIME REGAINS A SIGNIFICANT VOLUME OF OIL BUSINESS, ASSUMING ALWAYS THAT SHIP-OWNERS AND INSURERS JUDGE THE POLICITAL RISKS IN THE AREA TO BE ACCEPTABLE.

5. VIRTUALLY ALL MODERN CONTAINER VESSELS WILL BE ABLE TO USE THE CANAL AT THIS PRESENT WIDTH. IT IS UNLIKELY THAT THE CANAL MAY CONTRIBUTE TO A SURPLUS OF WORLD SHIPPING. THE NET EFFECT ON TRADING COSTS AND MARITIME EARNINGS COULD BE WITHIN THE NORMAL RANGE OF VARIATION IN THESE FIELDS.

6. EGYPT WILL UNDOUBTEDLY BENEFIT FROM THE RE-ESTABLISHMENT OF HER POSITION ON WORLD TRADE ROUTES AND FROM THE RE-ESTABLISHMENT OF THE CANAL TOWNS. THERE WILL BE SOME IMPROVEMENT IN ECONOMIC CONFIDENTIAL

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PROSPECTS FOR THE PDRY, SAUDI ARABIA, YAR, SUDAN, SOMALIA AND ETHIOPIA. THE ECONOMIC EFFECT ON THE SOVIET UNION WILL BE MINIMAL. THE BENEFITS TO BE GAINED FROM THE REOPENING OF THE CANAL WILL NOT BE A DECISIVE DETERRENT TO EGYPTIAN PARTICIPATION IN HOSTILITIES. THERE COULD BE SOME POLITICAL EFFECTS ON THE DEVELOPMENT OF THE PDRY.

7. FREEDON OF PASSAGE FOR ISRAELI SHIPS REMAINS A MAJOR ISSUE. OTHER MARITIME POWERS - INCLUDING THESOVIET UNION - WILL HAVE GREATERSTRATEGIC FLEXIBILITY WHEN TNE CANALIS OPEN BUT NONE WILL WISH TORELY TOOHEAVILY ON THE CANAL ROUTE. THERE WILL OE LITTLE EFFECT ON THE EAST-WEST BALANCE IN THE SOUTHERN INDIAN OCEAN. THE RUSSIANS CAN BE EXPECTED TO CONTINUE TO TRY TO ESTABLISH

A PRESENCE IN THE GULF AREA. THE GREATER NAVAL FLEXIBILITY
WOULD HELP THEM TAKE ADVANTAGE OF ANY CHANGING POLITICAL SITUATION
IN THE LITTORAL STATES OF THE RED SEA, GULF AND EAST AFRICA
AND IN ISLANDS IN THE AREA BUT THEY WOULD CONTINUE TO BE INHIBITED
BY THE THREAT OF WESTERN REACTION FROM INTERFERING DIRECTLY.

8. THE REOPENING OF THE CANAL WILL CAUSE NO SUBSTANTIAL SHIFT
IN ADVANTAGE TO EAST OR WEST. THERE WILL BE SOME COMMERCIAL OPP-
ORTUNITIES FOR BOTH AS WELL AS THE INCREASED FLEXIBILITY OF
DEPLOYMENT.

MAIN RPORT

RESTORATION AND REDEVELOPMENT OF THE CANAL

1. IN 1967 THE EGYPTIANS SANK A NUMBER OF VESSELS IN SIX SEPARATE
PARTS OF THE CANAL IN ORDER TO ENSURE ITS COMPLETE CLOSURE TO
ALL SHIPS. DURING THE 1973 WAR A SUBSTANTIAL ROCK AND RUBBLE
CAUSWAY WAS BUILT BY THE ISRAELIS NEAR DEVERSOIR TO SUPPORT THE
BRIDGEHEAD THEY HAD ESTABLISHED ON THE WEST BANK. THE WARS ALSO
DEPOSITED IN THE CANAL LARGE QUANTITIES OF UNEXPLODED WEAPONS
AND OTHER WAR DEBRIS, AND MINEFIELDS WERE LAID BY THE EGYPTIANS
IN THE FULF OF SUEZ AND MEDITERRANEAN APPROACHES. THERE HAS
ALSO BEEN CONSIDERABLE SILTING OF THE CANAL DURING ITS SEVEN YEARS
OF CLOSURE.

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2. THE OPERATION TO CLEAR THE CANAL OF EXPLOSIVES WAS LARGELY COMPLETED BY THE END OF 1974. SOME SHALLOW DRAUGHT EGYPTIAN VESSELS PASSED THROUGH THE CANAL LAST NOVEMBER BUT BEFORE IT CAN BE FULLY REOPENED THE SUEZ CANAL AUTHORITY (SCA) WILL HAVE TO COMPLETE THE REMOVAL OF SUNKEN WRECKS, REPAIR THE BED AND BANKS OF THE CANAL AND INSTALL NEW TELECOMMUNICATIONS, EQUIPMENT AND NAVIGATIONAL AIDS. SCA ESTIMATE THAT IF THEIR PROGRAMME IS ADHERED

TO IT SHOULD BE POSSIBLE TO REOPEN THE CANAL FOR COMMERCIAL SHIPPING WITH A MAXIMUM DRAUGHT OF 38 FT (THE PRE 1967 DRAUGHT) BETWEEN THE END OF APRIL AND THE END OF JUNE 1975. WE THINK THIS TIMING OPTIMISTIC AND THAT THE CANAL IS UNLIKELY TO BE BACK AT ITS PRE 1967 CONDITION MUCH BEFORE THE END OF 1975.

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3. IT MUST, HOWEVER, BE EMPHASISED THAT THE DATE OF THE REOPENING IS LIKELY TO DEPEND ON PROGRESS IN THE MEANTIME TOWARDS AN ARAB/ISRAEL SETTLEMENT. THE ISRAELIS HAVE PRESSED FOR THE CANAL TO BE REOPENED IN ADVANCE OF FURTHER ISRAELI CONCESSIONS AS ONE OF THE TESTS OF EGYPTIAN GOODWILL. CONVERSELY, THE EGYPTIANS REGARD THE CANAL AS ONE OF THEIR FEW BARGAINING COUNTERS AND IN NOVEMBER 1974 THE EGYPTIAN FOREIGN MINISTER STATED THAT EGYPT WOULD NOT OPEN THE CANAL UNTIL ISRAEL HAD COMPLETED A MAJOR WITHDRAWAL IN SINAI.

4. THE 38 FT DRAUGHT LIMIT WILL ONLY RESTORE THE CANAL TO ITS PRE-SIX DAY WAY CAPACITY AND THE EGYPTIANS HAVE RECOGNISED THAT A MAJOR PROPORTION OF THE WORLD'S TANKER SHIPPING WILL BE UNABLE TO TRANSIT. THEY HAVE THEREFORE DEVISED A TWO STAGE PLAN FOR ENLARGEMENT. STAGE 1 TAKING 3 YEARS TO COMPLETE WOULD BE TO PERMIT THE PASSAGE OF SHIPS WITH A DRAUGHT OF 53 FT; STAGE 2, ALSO ESTIMATED AS TAKING A FURTHER 3 YEARS WOULD ENLARGE THE WATERWAY TO TAKE SHIPS OF UP TO 70 FT DRAUGHT. THE THREE DRAUGHTS QUOTED ABOVE REPRESENT FOR OIL TANKERS DEAD WEIGHT TONNAGES (DWT) OF ABOUT 50,000, 150,000 AND AT LEAST 250,000 DWT RESPECTIVELY.

OVERALL ECONOMIC EFFECTS

THE OIL TRADE

5. IN 1966 THE OIL TRADE ACCOUNTED FOR NEARLY THREE-QUARTERS OF THE CANAL'S TRAFFIC (AND REVENUE). AT THE TIME SOME 80 PERCENT OF THE WORLD'S TANKERS WERE ABLE TO USE THE CANAL AT LEAST IN BALLAST. THE NEED TO USE THE CAPE ROUTE CONTRIBUTED TO A MARKED SHIFT IN TANKER BUILDING POLICY TOWARDS VERY LARGE CARRIERS. AS A RESULT, BY JUNE 1974 ONLY ABOUT ONE-FIFTH OF THE WORLD TANKER FLEET COULD, WHEN LOADED (UP TO 50 PERCENT IF WE COUNT BALLAST PASSAGES), USE THE CANAL AT ITS PRE-1967 CONDITION. IT IS PROBABLE THAT CONSIDERATIONS OF TANKER SIZE WILL CONTINUE TO RESTRICT THE CANAL'S ABILITY TO CARRY OIL TRAFFIC AT LEAST

UNTIL STAGE 2 OF ENLARGEMENT HAS BEEN COMPLETED IN 1980. (THERE ARE HOWEVER MANY STATISTICAL UNCERTAINTIES.) AN ADDITIONAL FACTOR MILITATING AGAINST THE USE OF THE CANAL FOR OIL TRADE IS THE EXPANSION OF PIPELINE FACILITIES TO THE MEDITERRANEAN. THE SUEZ TO ALEXANDRIA PIPELINE (SUMED) WHICH COULD CARRY UP TO 80 MILLION TONS PER ANNUM WITHIN 2 OR 3 YEARS OF ITS COMPLETION (NOW ANTICIPATED FOR 1977), MAY PROVE TO BE A COMPETITOR WITH THE CANAL ALTHOUGH THE EGYPTIANS HOPE IT WILL

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ATTRACT BUSINESS ON THE GROUNDS THAT SHIPS WHICH ARE TOO LARGE TO TRANSIT FULLY LOADED WILL DO SO PARTIALLY LOADED AND THEN TOP UP FROM THE PIPELINE.

6. THERE ARE SOME FACTORS WHICH SHOULD MORE DEFINITELY ENCOURAGE THE USE OF THE CANAL FOR OIL TRADE. FIRST, THERE IS THE EXPECTED RISE IN GULF OIL TRADE TO EUROPE, NOTWITHSTANDING CONSERVATION MEASURES AND SLOWER ECONOMIC GROWTH, FROM 190 MILLION TONS IN 1966 TO ABOUT 700 MILLION TONS IN 1980. (THE EEC ALONE IS PLANNING TO IMPORT 640 MILLION TONS IN 1980, MOST OF WHICH WILL COME FROM THE GULF.) SECONDLY, UNITED STATES IMPORTS OF 350 MILLION TONS PER ANNUM, OF WHICH ABOUT 50 MILLION TONS COME FROM ARAB PRODUCERS, MAY WELL INCREASE BY A FURTHER 300 MILLION TO 350 MILLION TONS PER ANNUM, DEPENDING ON THE SUCCESS OF CONSERVATION AND SUBSTITUTION MEASURES. THE MAJOR PART OF THIS INCREASE WOULD HAVE TO COME FROM THE GULF - MAINLY FROM SAUDI ARABIA; AND BECAUSE THERE ARE NO DEEP WATER PORTS ON THE UNITED STATES EASTERN SEABOARD AT LEAST SOME OF THIS OIL WOULD BE LIKELY TO GO IN SHIPS SMALL ENOUGH TO BE ABLE TO TRANSIT SUEZ. (SOME WOULD GO IN BIG SHIPS FOR TRANSHIPMENT IN THE CARIBBEAN). THIRDLY, BY 1980 THE GULF PRODUCERS MAY ON A RECENT EEC ESTIMATE, HAVE REFINERY CAPACITY OF 283 MILLION TONS. A SIGNIFICANT PROPORTION OF THE OIL TRADE FROM THE GULF WILL THEREFORE BE REFINED PRODUCTS, AND SO TRANSPORTED IN SMALLER SHIPS THAN IF IT WERE CRUDE. ON BALANCE WE THINK THAT IN TIME, AND GIVEN SOME YEARS OF PEACE IN THE AREA, THE CANAL WILL REGAIN A SIGNIFICANT VOLUME OF OIL TRADE. BUT THE CANAL'S IMMEDIATE PROSPECTS OR RECAPTURING THE SAME HIGH PROPORTION OF THE WORLD'S OIL TRADE AS BEFORE ARE NOT BRIGHT BOTH BECAUSE OF THE INITIAL PROBLEM OF TANKER SIZE AND BECAUSE OF SHIPOWNERS' (AND PROBABLY INSURERS) PRESENT NERVOUSNESS ABOUT THE STABILITY OF THE AREA.

THE NON-OIL TRADE

7. THE ANNUAL INCREASE IN EXPORTS FROM THE WEST TO THE MIDDLE EAST OIL PRODUCERS CURRENTLY 20-30 PERCENT SHOULD REMAIN LARGE, AND MUCH OF THIS TRAFFIC IS LIKELY TO USE THE CANAL. THE REOPENING OF THE CANAL SHOULD IMPROVE WEST EUROPE'S ABILITY TO COMPETE WITH JAPAN AND THE INDIAN MARKET AND TO A LESSER EXTENT, THE MARKETS FURTHER EAST. VIRTUALLY ALL THE MODERN CONTAINER VESSELS COULD

USE THE CANAL AT THE 38 FT LIMIT, BUT THE LARGEST SHIPS ON THE

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FAR EAST RUN COULD ONLY TRANSIT PART LOADED. PASSENGER SERVICES HAVE DECLINED DRASTICALLY SINCE 1967 AND THE EGYPTIAN AND RED SEA PORTS WILL NOT RECOVER THE MANY FRINGE BENEFITS WHICH THESE SERVICES USED TO OFFER. THE EXTENT TO WHICH THE CANAL WILL REGAIN TRADE, BOTH OIL AND NON-OIL, WILL DEPEND, AMONG OTHER THINGS, ON THE LEVEL OF CANAL DUES, INSURANCE PREMIUMS AND, ESPECIALLY IN THE OIL TRADE, COMMERCIAL CONFIDENCE IN THE FUTURE OF THE CANAL. NO RELIABLE INFORMATION IS YET AVAILABLE ON THE LEVEL OF CANAL DUES. THE CHAIRMAN OF THE SCA SAID IN MARCH 1974 THAT THEY HOPED INITIALLY FOR AN ANNUAL GROSS INCOME OF 256 MILLION DOLLARS RISING TO 384 MILLION DOLLARS AT THE STAGE 1 ENLARGEMENT. COMPARED WITH THE 1966 RECEIPTS OF \$219 MILLION AND ALLOWING FOR INFLATION, THESE FIGURES SUGGEST THAT THE SCA ARE NOT EXPECTING MORE TRAFFIC AT THE END OF THE FIRST STAGE OF ENLARGEMENT THAN THEY HAD IN 1966.

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8. THE REOPENING OF THE CANAL WILL HAVE SOME EFFECT ON THE PATTERN OF DEMAND FOR WORLD SHIPPING AND ON SHIPPING COSTS. THIS IS A DIFFICULT AREA IN WHICH TO MAKE FORECASTS. IN THIS AND THE FOL-

LOWING PARAGRAPHS WE CAN MAKE ONLY TENTATIVE SUGGESTIONS ABOUT WHAT MAY HAPPEN. SHORTER JOURNEYS, WITH THE CONSEQUENT GREATER UTILISATION OF A SHIP, WOULD SUGGEST THAT THERE MAY BE A SURPLUS OF SHIPPING. WITH A SURPLUS OF CRUDE CARRIER TONNAGE IN PROSPECT IN ANY CASE, AN ADDITIONAL SURPLUS (EVEN OF A SMALL PERCENTAGE OF TONNAGE) CONSEQUENT UPON A REOPENING, WOULD EXACERBATE THE SITUATION. (THE LIKELIHOOD OF SURPLUS TONNAGE RESULTING FROM THE REOPENING IS BORNE OUT BY ESTIMATES MADE IN 1971 BY SHELL, WHO ARRIVED AT A FIGURE OF 6 PERCENT FOR TANKERS.) THE SURPLUS OF OTHER SHIPPING WOULD PROBABLY BE LESS THAN THAT FOR TANKERS.

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9. SINCE THE CLOSURE OF THE CANAL AN AVERAGE SURCHARGE OF 25 PER CENT OF 1967 FREIGHT TARIFFS HAS BEEN APPLIED TO THESE DRY CARGOES WHICH WOULD FORMALLY HAVE USED THE CANAL. THE REOPENING OF THE CANAL SHOULD REMOVE THIS. THERE ARE OF COURSE, CONSIDERABLE SAVINGS IN DISTANCES: FOR EXAMPLE, THE CANAL WILL SHORTEN THE DISTANCE FROM THE GULF TO ROTTERDAM BY 43 PERCENT. IN PRACTICE, HOWEVER, TIME SPENT IN THE CANAL, INSURANCE PREMIA FOR PASSAGE THROUGH WHAT WILL BE AGAIN ONE OF THE MOST CONGESTED SEA ROUTES IN THE WORLD, CANAL DUES AND THE FACT THAT ON MANY ROUTES, EG IRAN TO JAPAN, OR NIGERIA TO EUROPE, THERE ARE NO SAVINGS AT ALL, INDICATE THAT THE AVERAGE SAVINGS IN COST WILL BE SMALL. INDEED WE BELIEVE THAT THEY COULD BE LESS THAN THE NORMAL RANGE OF FLUCTUATION OF FREIGHT RATES IN THE OPEN MARKET WHERE MOST SHIPPING IS ARRANGED. THIS BEING SO, FOR IMPORTANT TRADING NATIONS, INCLUDING THE UNITED KINGDOM THE NET EFFECT OF THE REOPENING OF THE CANAL ON TRADING COSTS AND MARITIME EARNINGS COULD BE WITHIN THE NORMAL RANGE OF VARIATION IN THESE FIELDS.

ECONOMIC IMPLICATIONS FOR COUNTRIES IN THE AREA
EGYPT

10. EVEN ON THE MOST PESSIMISTIC ESTIMATE OF THE VOLUME OF SHIPPING LIKELY TO USE THE CANAL, THERE IS NO DOUBT THAT THE CANAL WILL BE FOR EGYPT AN IMPORTANT SOURCE OF FOREIGN EXCHANGE. BUT THE IBRD ESTIMATE THAT RESTORATION TO THE ORIGINAL STANDARD SHOULD BRING IN NO MORE THAN GWTP MILLION A YEAR BY 1980. THE COST OF RESTORING THE CANAL TO THIS STANDARD WILL BE \$280-300 MILLION, SOME \$180 MILLION OF WHICH WILL BE A FOREIGN EXCHANGE COST, OF WHICH PART HAS ALREADY BEEN RAISED ON SOFT TERMS. ALTHOUGH THE TERMS OF THE LOAN MAY BE GENEROUS, REPAYMENTS WILL BE AN OFFSET TO FOREIGN EXCHANGE EARNINGS FROM THE CANAL. STAGE 1 AND 2 ENLARGEMENTS MIGHT REQUIRE AT LEAST A FURTHER \$800 MILLION.

11. NEVERTHELESS, EGYPT WILL UNDOUBTEDLY BENEFIT FROM THE CANAL. SHE WILL AGAIN BE ON THE WORLD TRADE ROUTES AND THERE ARE LIKELY TO BE SIGNIFICANT, THOUGH AT PRESENT UNQUANTIFIABLE, SPIN-OFFS FROM THE TRANSIT TRADE, SERVICING OF FOREIGN SHIPS AND TOURISM. PERHAPS THE MOST FAR-REACHING IMPACT ON THE EGYPTIAN ECONOMY WILL

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COME FROM THE RE-ESTABLISHMENT OF THE CANAL TOWNS, WHICH ARE TO BE REBUILT AT AN ESTIMATED COST OF \$8,000 MILLION OVER THE NEXT 5 YEARS. EGYPT HAS BEEN PROMISED CONTRIBUTIONS TOWARDS THIS COST FROM THE OIL STATES AND HOPES THAT FOREIGN LOANS AND PRIVATE INVESTMENT WILL MEET THE BALANCE. TO THIS END SHE HAS ALREADY LIBERALISED THE TERMS FOR FOREIGN INVESTMENT AND THE STATEMENT ISSUED AT THE END OF PRESIDENT NIXONS VISIT TO CAIRO IN JUNE ANNOUNCED THAT US INVESTMENT PROPOSALS UNDER SERIOUS DISCUSSION WERE ESTIMATED AT 2,000 MILLION.

ISRAEL

12. THE EFFECT OF THE REOPENING OF THE CANAL ON THE ISRAELI ECONOMY WILL BE MINIMAL, SINCE ISRAEL HAS PORTS IN THE MEDITERRANEAN AND THE RED SEA.

PDRY

13. THE CLOSURE OF THE CANAL, COINCIDING AS IT DID WITH THE BRITISH WITHDRAWAL FROM ADEN, HAD A DISASTEROUS EFFECT ON THE ECONOMY OF THE PDRY. THE PORT OF ADEN BECAME ALMOST OVERNIGHT AN ECONOMIC BACKWATER. THE OIL REFINERY, WHICH HAS AN ANNUAL CAPACITY OF 8 MILLION TONS, DECLINED FROM 1966 OUTPUT OF 7 MILLION TONS TO 3.3 MILLION TONS IN 1972. THE PDRY HAS RECEIVED AID FROM THE RUSSIANS EAST EUROPEANS, CUBA AND THE CHINESE AND, MORE RECENTLY, FROM SOME ARAB OIL PRODUCERS. BUT NONE OF THIS HAS PREVENTED A STATE OF NEAR BANKRUPTCY. THE PDRY CAN EXPECT SOME IMPROVEMENT IN ITS ECONOMIC PROSPECTS WITH THE CANAL REOPENS. THE PDRY GOVERNMENT ITSELF BELIEVES THAT ADEN HARBOUR WILL ATTRACT 70 PERCENT OF ITS FORMER TRADE. BUT IT IS LIKELY THAT IN MAKING THIS ASSESSMENT THE GOVERNMENT ANTICIPATED AN EXPANSION OF THE OIL REFINERY. HOWEVER THIS IS NOT AN ATTRACTIVE COMMERCIAL PROPOSITION BECAUSE SUPER-TANKERS ARE TOO BIG FOR THE HARBOUR: CONTAINER SHIPS AND BULK CARRIERS ARE REPLACING THE OLD CARGO SHIPS; AND OTHER PORTS, NOTABLY DJIBOUTI, ARE LIKELY TO MAKE STRONG BIDS TO CAPTURE SOME OF THE TRADE. NEVERTHELESS ADEN'S LARGE HARBOUR WITH PLENTY OF WHARF AND WAREHOUSE SPACE, ITS GEOGRAPHIC LOCATION AND IF THE PDRY GOVERNMENT SO CHOOSES, LOW BUNKERING COSTS, ARE ALL LIKELY TO ENSURE THAT AT LEAST SOME BUSINESS WILL RETURN. BUT THE PDRY IS UNLIKELY TO RECOVER ITS 1967 INCOME IN REAL TERMS AND WE DOUBT WHETHER IT WILL EVEN MANAGE TO DO SO IN MONEY TERMS.

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SAUDI ARABIA AND YAR

14. THE REOPENING OF THE CANAL IS LIKELY TO GIVE SOME IMPETUS TO THE DEVELOPMENT OF WESTERN AREAS OF SAUDI ARABIA, WHERE THERE HAS RECENTLY BEEN SOME DRILLING FOR OIL, ALBEIT NOT YET SUCCESSFUL. IN PARTICULAR THE PART OF JIDDA SHOULD BENEFIT: THE PORT HAS

RECENTLY BEEN EXTENSIVELY DEVELOPED AND FURTHER EXTENSIONS ARE IN PROGRESS. THE REOPENING OF THE CANAL SHOULD REDUCE FREIGHT CHARGES ON THE YAR'S IMPORTS FROM WESTERN EUROPE (APPROXIMATELY 25 PERCENT ON THE TOTAL IMPORT IN 1973 LV AND HSTN# THE EXPANSION ON THE PORT AT HODEIDA.

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AFRICA

15. BECAUSE OF HER LOCATION, THE SUDAN WAS HIT PROBABLY MORE THAN ANY OTHER COUNTRY BY THE INCREASED SHIPPING COSTS WHICH FOLLOWED THE CLOSURE OF THE CANAL. THERE SHOULD BE A SUBSTANTIAL REDUCTION IN THESE COSTS WHEN THE CANAL REOPENS AND THIS IN TURN SHOULD PROVIDE AN IMPORTANT BOOST TO HER EXPORTS ON COTTON AND SUGAR. SIMILARLY SOMALIA AND THE FRENCH TERRITORY OF THE AFARS AND ISSAS, WHICH WERE ALSO SERIOUSLY AFFECTED, CAN BE EXPECTED TO BENEFIT CONSIDERABLY BY THE REOPENING OF THE CANAL. THE SHORTER TRADE ROUTE IS LIKELY ALSO TO BENEFIT TRADE BETWEEN EUROPE AND THE COUNTRIES OF EAST AFRICA.

SOUTH AFRICA WOULD LOSE SOME REVENUES BUT HER OWN TRADE IS OVERWHELMINGLY WITH THE INDUSTRIAL WEST AND JAPAN AND THERE

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WOULD BE NO BENEFIT IN SWITCHING TO TH CANAL.

ECONOMIC IMPLICATIONS FOR THE SOVIET UNION

16. THE CONTRIBUTION TO THE SOVIET ECONOMY OF FOREIGN TRADE AMOUNTS TO ONLY ABOUT 7-8 PERCENT OF HER (ESTIMATED) GNP, AND IN 1967 ONLY 5 PERCENT OF THIS TRADE USED THE CANAL. THE GREATER PART OF SOVIET IMPORTS THROUGH THE CANAL WERE OF RAW MATERIALS, SUCH AS RUBBER, TIN, WOOL, AND WHAT FROM THE FAR EAST AND AUSTRALASIA. MOST SOVIET EXPORTS TO THE AREA WERE ALSO OF RAW MATERIALS, OIL AND SOME MANUFACTURES. AN IMPORTANT SAVING IN TIME AND, PRESUMABLY, COST WOULD OCCUR IN SOVIET-INDIAN TRADE AND IN SOVIET AID TO INDIA. INDIA IS NOW THE SOVIET UNIONS LEADING TRADE PARTNER IN THE THIRD WORLD, ACCOUNTING FOR NEARLY 2 PERCENT OF THE TOTAL SOVIET TURNOVER AND NEARLY 3 PERCENT OF INDIAS. BUT THE SUM OF SOVIET FOREIGN TRADING VENTURES IS VERY SMALL BY MOST WESTERN STANDARDS AN THUS IN PURELY ECONOMIC TERMS, THE CANAL IS UNLIKELY TO BE IMPORTANT TO THE SOVIET UNION.

POLITICAL IMPLICATIONS IN THE MIDDLE EAST

17. FOR THE MIDDLE EAST PEACE NGOTIATIONS THE REOPENING OF THE CANAL WILL BE AN IMPORTANT STEP IN BUILDING CONFIDENCE AND AS EVIDENCE OF EGYPTS KEENNESS TO AVOID FURTHER HOSTILITIES. AS SUCH, IT WILL BE WELCOME TO ISRAEL. RENEWAL OF CANAL OPERATIONS AND THE RE-BUILDING OF TOWNS IN THE AREA WILL BE AN IMPORTANT FACTOR IN EGYPTIAN CALCULATIONS AS TO WHETHER TO INITIATE OR JOIN IN HOSTILITIES; BUT IT WILL NOT BE A DECISIVE DETERRENT IF THE PROSPECTS OF RECOVERING THE BULK OF SIANI BY PEACEFUL MEANS FADES AWAY. THE EGYPTIANS WILL CALCULATE THAT ANY DAMAGE TO THE CANAL ZONE IN FUTURE HOSTILITIES WILL FIND WILLING UNDERWRITERS AMONG THE ARAB OIL STATES.

18. WE SEE THE REOPENING OF THE CANAL AS HAVING SOME POLITICAL IMPLICATIONS FOR THE PDRY. WE HAVE ALREADY REFERRED TO THE ECONOMIC PROSPECTS WHICH THE REOPENING OF THE CANAL WILL OFFER TO THE PDRY. IS COULD BE THAT THE RESTORATION OF FOREIGN EXCHANGE EARNINGS AND EXPOSURE OT WESTERN INFLUENCES THROUGH INCREASED TRADE WILL INDUCE SOME LIBERALISATION OF THE DOCTRINAIRO POLICIES ON THE LEFT-WING REGIME, COMING AT A TIME WHEN IN ANY CASE THE REGIME IS UNDER SOME PRESSURE FROM EGYPT AND MODERATE ARAB STATES TO MODIFY ITS POLICIES. ON THE OTHER HAND AN UPTURN IN THE ECONOMY WOULD MAKE THE REGIME SLIGHTLY LESS DEPENDENT

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ON EXTERNAL AID AND MORE CONFIDENT OF BEING ABLE TO RESIST EXTERNAL PRESSURES. WE DOUBT WHETHER THE REOPENING OF THE SUEZ CANAL WILL PROVE A DETERMINING FACTOR IN ANY CHANGES IN PDRY'S INTERNAL OR EXTERNAL POLICIES. ON BALANCE WE THINK THAT ANY ECONOMIC IMPROVEMENT THAT RESULTS IS LIKELY TO BOLSTER EXISTING POLITICAL

ATTITUDES.

STRATEGIC IMPLICATIONS: GENERAL

19. IN THE FOLLOWING PARAGRAPHS WE ASSUME THAT THERE WILL BE NO NO PROHIBITION OF THE PASSAGE OF WAR SHIPS (OTHER THAN PERHAPS ISRAELI - WE DEAL WITH THIS PROBLEM IN PARAGRAPH 20) THROUGH THE CANAL.

THE MOST OBVIOUS STRATEGIC RESULT OF THE REOPENING WILL BE THAT MARITIME POWERS WILL HAVE A RENEWED FLEXIBILITY BOTH FROM THE POINT OF VIEW OF DEPLOYMENT AND LOGISTICAL SUPPORT. WE EXAMINE IN MORE DETAIL IN PARAGRAPHS 21-23 THE ADVANTAGES TO THE SOVIET UNION. BUT WESTERN NAVIES COULD ALSO MAKE MAJOR TIME SAVINGS. FOR INSTANCE SHIPS LEAVING BRITAIN WOULD HALVE THE DISTANCE TO ADEN BY TRAVELLING VIA THE CANAL, AND THE UNITED STATES UNITS FROM THE SIXTH FLEET DEPLOYING TO THE GULF OF ADEN WOULD TRAVEL 1,500 MILES FROM THE EASTERN MEDITERRANEAN AS OPPOSED TO 10,500 ROUND THE CAPE. BUT NONE WILL WISH TO RELY TOO HEAVILY ON THE CANAL ROUTE, SUBJECT AS IT IS TO SUDDEN CLOSURE, EGYPTIAN DIPLOMATIC LEVERAGE AND BOTTLE NECK IN THE RED SEA.

ISRAEL

20. FREEDOM OF PASSAGE FOR ISRAELI SHIPS REMAINS A MAJOR ISSUE. THE EGYPTIAN FOREIGN MINISTER STATED RECENTLY THAT NO ISRAELI SHIP WOULD BE ABLE TO USE THE CANAL UNTIL THERE WAS AN OVERALL MIDDLE EAST PEACE SETTLEMENT. THE ISRAELI FOREIGN MINISTER LATER SAID THAT THE EGYPTIANS HAD ALREADY SECRETLY AGREED THAT ISRAELI SHIPS COULD USE THE CANAL AT SOME STAGE OF PEACE NEGOTIATIONS. WE THINK THAT, IN THE EVENT, THE EGYPTIANS WILL FIND IT HARD TO BRING THEMSELVES TO ALLOW PASSAGE RIGHTS TO ANY ISRAELI SHIPS FOR SOME TIME AND MAY WELL NEVER ACCEPT ISRAELI WARSHIPS. THERE WILL PROBABLY BE PRESSURES ON ISRAEL NOT TO PRESS THIS ISSUE TOO HARD; SHE HAS HER OWN LAND BRIDGE BETWEEN THE RED SEA AND THE MEDITERRANEAN AND CAN DO WITHOUT THE CANAL PROVIDED SHE RETAINS ACCESS TO THE RED SEA.

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USIA-06 SAJ-01 AID-05 EB-07 NSC-05 CIEP-01 SS-15

STR-01 OMB-01 CEA-01 COME-00 SAB-01 SAM-01 FEA-01

INT-05 FMC-01 DLOS-03 /101 W

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R 221825Z JAN 75

FM USMISSION NATO
TO SECSTATE WASHDC 9703
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INFO ALL NATO CAPITALS 4917
AMEMBASSY CAIRO
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THE SOVIT UNION

21. THE MAIN EFFECT ON THE SOVIET UNION OF THE REOPENING OF THE SUEZ CANAL WILL BE THE SHORTENING OF THEIR LINES OF COMMUNICATION FROM THE BLACK SEA TO THE REDSEA, THE GULF AND THE NORTHERN INDIAN OCEAN. THERE WILL BE LITTLE EFFECT ON THE BALANCE IN THE SOUTHERN INDIAN OCEAN AS BOTH THE USSR AND THE UNITED STATES CAN AS EASILY DEPLOY NAVAL UNITS FROM THEIR EASTERN OR WESTERN SEABOARDS. THE SOVIET NAVY WILL BE ABLE TO DEPLOY SHIPS TO THE NORTHERN INDIAN OCEAN MUCH MORE QUICKLY THAN BEFORE. THE DISTANCE BETWEEN ODESSA AND ADEN VIA THE CANAL IS 2,500 MILES AS OPPOSED TO 11,500 MILES VIA THE CAPE. VLADIVOSTOK TO ADEN IS 7,700 MILES. HOWEVER WE EXPECT THAT EVEN WHEN THE CANAL REOPENS THE BULK OF THE SOVIET NAVAL PRESENCE IN THE INDIAN OCEAN AS A WHOLE WILL CONTINUE TO BE DRAWN FROM THE PACIFIC FLEET. THE
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BLACK SEA IS ALREADY WELL COMMITTED IN PROVIDING VESSELS FOR THE MEDITERRANEAN SQUADRON BUT SHIPS COULD CLEARLY BE DEPLOYED MUCH MORE EASILY FOR TEMPORARY ATTACHMENTS IN THE GULF AND NORTHERN INDIAN OCEAN AREAS. THE REOPENING OF THE CANAL WOULD ALSO FACILITATE LOGISTICAL SUPPORT FOR THE INDIAN OCEAN SQUADRON FROM THE BLACK SEA PORTS.

22. THE RUSSIANS HAVE BEEN MAKING CONSIDERABLE EFFORTS TO DEVELOP THEIR INFLUENCE IN SOMALIA AND THE PDRY. THEY HAVE GIVEN MILITARY AND ECONOMIC AID TO BOTH, AND HAVE ACQUIRED SHORE FACILITIES IN SOMALIA. THEY ALSO MAKE CONSIDERABLE USE OF THE PORT OF ADEN. THE MILITARY TAKEOVER IN ETHIOPIA MAY ALSO PROVIDE AN OPPORTUNITY FOR THE RUSSIANS TO IMPROVE THEIR POSITION THERE ALTHOUGH THEY WILL HAVE TO TAKE INTO ACCOUNT THE EFFECT OF ANY SUCH MOVES ON THEIR RELATIONS WITH SOMALIA. IN THE PERSIAN GULF THEY MAKE CONSIDERABLE USE OF THE PORT OF OASRA AND UMM QASR, BUT HAVE SO FAR FAILED TO ESTABLISH A POSITION OF INFLUENCE IN ANY COUNTRY OTHER THAN IRAQ. ONCE THE CANAL IS OPEN THE RUSSIANS MAY STEP UP THEIR EFFORTS TO ESTABLISH THEIR PRESENCE IN THE PERSIAN GULF PARTICULARLY THROUGH A GRADUAL INCREASE IN THEIR NAVAL PRESENCE.

23. THE REOPENING OF THE CANAL WILL GIVE SOVIET NAVAL POWER ADDED FLEXIBILITY. WE DO NOT SEE THEM USING THIS TO STEP UP ANY

KIND OF NAVAL "RACE" WITH THE WEST. BUT THERE ARE MANY COUNTRIES IN THE RED SEA AND THE GULF AND EAST AFRICA, AS WELL AS MAURITIUS AND THE SEYCHELLES, WHERE THE RUSSIANS COULD WISH TO TAKE ADVANTAGE OF ANY CHANGING POLITICAL SITUATION. WE WOULD EXPECT THEM TO STEP UP THE FREQUENCY OF PATROLS IN THE RED SEA. IT WOULD BE IN KEEPING WITH THEIR GENERAL NAVAL POLICY FOR THEM TO SEE THE EASIER DEPLOYMENT OF THEIR NAVAL POWER AS GIVING THEM AN ADDITIONAL CAPABILITY TO INFLUENCE INTERNAL POLICIES OF SOME LITTORAL STATES. THEY WOULD CONTINUE TO BE INHIBITED BY THE THREAT OF WESTERN REACTION FROM USING NAVAL POWER TO INTERFERE DIRECTLY IN THE LITTORAL STATES, BUT IF AT ANY STAGE THEY FELT THAT THEY COULD ACT QUICKLY AND DECISIVELY IN A CHANGING SITUATION WITHOUT PROVOKING WESTERN REACTION THEY WOULD BE ABLE TO DO SO.

THE BALANCE OF EAST WEST ADVANTAGE

24. WE CONCLUDE THAT THE REOPENING OF THE CANAL WILL CAUSE NO SUBSTANTIAL SHIFT IN ADVANTAGE TO EITHER EAST OR WEST. WE HAVE
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SEEN THAT THE COMMERCIAL ADVANTAGES TO THE EASTERN BLOC WILL NOT BE GREAT ALTHOUGH THERE WILL BE SOME NEW OPPORTUNITIES. THERE WILL BE SOME ADVANTAGES TO WESTERN TRADING NATIONS, BUT THE SHIPPING COSTS SAVED BY THE REOPENING OF THE CANAL MAY NOT BE OUTSIDE THE NORMAL VARIATION OF FREIGHT CHARGES. ALL NAVAL POWERS WILL BENEFIT FROM THE INCREASED FLEXIBILITY OF DEPLOYMENT. THIS WILL ASSIST SOVIET EFFORTS TO INFLUENCE EVENTS IN THE RED SEA, EAST AFRICA AND THE PERSIAN GULF, BUT NOT TO AN EXTENT, GIVEN THE ADDED FLEXIBILITY OF WESTERN POWERS DEPLOYMENT, WHICH WILL RADICALLY ALTER THE BALANCE OF INFLUENCE IN THESE AREAS.
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Message Attributes

Automatic Decaptioning: X
Capture Date: 18 AUG 1999
Channel Indicators: n/a
Current Classification: UNCLASSIFIED
Concepts: n/a
Control Number: n/a
Copy: SINGLE
Draft Date: 22 JAN 1975
Decaption Date: 01 JAN 1960
Decaption Note:
Disposition Action: RELEASED
Disposition Approved on Date:
Disposition Authority: GolinoFR
Disposition Case Number: n/a
Disposition Comment: 25 YEAR REVIEW
Disposition Date: 28 MAY 2004
Disposition Event:
Disposition History: n/a
Disposition Reason:
Disposition Remarks:
Document Number: 1975NATO00343
Document Source: ADS
Document Unique ID: 00
Drafter: n/a
Enclosure: n/a
Executive Order: 11652 GDS
Errors: n/a
Film Number: n/a
From: NATO
Handling Restrictions: n/a
Image Path:
ISecure: 1
Legacy Key: link1975/newtext/t19750188/abbrzhsz.tel
Line Count: 685
Locator: TEXT ON-LINE
Office: n/a
Original Classification: CONFIDENTIAL
Original Handling Restrictions: n/a
Original Previous Classification: n/a
Original Previous Handling Restrictions: n/a
Page Count: 13
Previous Channel Indicators:
Previous Classification: CONFIDENTIAL
Previous Handling Restrictions: n/a
Reference: USNATO 0325
Review Action: RELEASED, APPROVED
Review Authority: GolinoFR
Review Comment: n/a
Review Content Flags:
Review Date: 28 APR 2003
Review Event:
Review Exemptions: n/a
Review History: RELEASED <28 APR 2003 by ElyME>; APPROVED <29 APR 2003 by GolinoFR>
Review Markings:

Margaret P. Grafeld
Declassified/Released
US Department of State
EO Systematic Review
05 JUL 2006

Review Media Identifier:
Review Referrals: n/a
Review Release Date: n/a
Review Release Event: n/a
Review Transfer Date:
Review Withdrawn Fields: n/a
Secure: OPEN
Status: NATIVE
Subject: NATO STUDY ON THE IMPLICATIONS OF REOPENING THE SUEZ CANAL
TAGS: PFOR, MILI, NATO, OR, XF, XG, XI
To: STATE
SECDEF INFO ALL NATO CAPITALS
CAIRO
MOSCOW
USLOSACLANT
CINCEUR

USNMR SHAPE
USDOCOSOUTH

Type: TE

Markings: Margaret P. Grafeld Declassified/Released US Department of State EO Systematic Review 05 JUL 2006